CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 226

October 27, 1959

CAPITAL EXPENDITURES, EXPENSE: UNDEPRECIATED BASIS AND COST OF DEMOLITION OF OR REMOVAL OF BUILDINGS

Syllabus:

(1) Where property is purchased with the intent to demolish it, the entire purchase price plus the cost of demolition is a capital expenditure.

(2) Where the intent to demolish originated after the property was purchased, the undepreciated basis of the old building and cost of demolition is a deductible loss.

Section 165(a) Internal Revenue Code (1954), Section 17206(a) Personal Income Tax Law and Section 24347(a) Bank and Corporation Tax Law, state the general rule that any loss sustained during the taxable year and not compensated by insurance is deductible. The Federal regulation (Sec. 1.165-1) and California regulations (17306(b) and 24121(d)(2) are substantially the same and have been judicially interpreted.

(1) The regulations provide that when real property is purchased with the intent to demolish an existing building and to replace it with another, no deductible loss is sustained by reason of the demolition of the old building. The courts agree with this position whether the intent was to demolish the whole building or only a part of it. The rationale of these cases is that, where there is a purchase of land with the intent to demolish any buildings situated thereon and erect new ones, the entire purchase price is paid for the land and nothing is paid for the buildings, since they have no value to the purchaser.

(2) The regulations state that a loss due to the voluntary removal or destruction of old buildings is deductible. However, there are two conflicting views in the case.

The line of authority followed by the Internal Revenue Service and the Franchise Tax Board, Union Bed & Spring Company v. Commissioner, 39 Fed. 383 (1930), holds the intent of the purchaser on the acquisition of the property is controlling, if at that time the taxpayer intended to use the building, then a part of the purchase price was paid for it. If he later tears the house down he parts with something he has paid money for and has sustained a deductible loss.